The Study Group on the Use of Market Mechanisms in the Federal Student Loan Programs will examine at least three market mechanisms over the next several months. To facilitate comparison of various market mechanisms, this standard format for comparing proposals has been developed.

Short Description of Proposal: Retail Market Competition with Focused Distribution of Subsides Based on Post-Graduation Circumstances.

What is the Principal Market-Mechanism? Retail market competition between originating lenders.

What federal agencies would be involved in administering the program? U.S. Department of Education. No other agencies.

Is there are a federally-supported guaranty? (Yes or No? Explain how it would work). Yes. The proposal assumes the continuation of the current system of guarantees, although the level of guarantees could in theory be reduced.

What loan provider risk sharing is proposed? (Please specify the percent proposed) Two percent lender/holder risk sharing. As noted above, depending on other program variables, lender/holder risk sharing could be increased.

<u>What are the conditions of insurance? (Example: Compliance with federally-specified due diligence in collecting delinquent loans)</u> The lender must service loans in accordance with federally-specified standards as administered through guaranty agencies.

<u>Who originates the loans?</u> Loans would be administered through originating lenders, as under the current program.

<u>How would the program assure the availability of loans to all eligible students?</u> (Please specify how) The program permits greater lender/holder discretion in setting borrower interest rates. This discretion, coupled with the continuation of 98 percent insurance coverage, will assure that loans remain available to all eligible students.

<u>Who is responsible for servicing during the in-school, grade and deferment period?</u> The lender or subsequent holder.

<u>Who is responsible for servicing during repayment periods?</u> The lender or subsequent holder.

<u>How are servicing arrangements determined?</u> (Role of school, ED, and loan providers) The lender or subsequent holder makes this determination. There is no provision for school input, other than that resulting from retail market competition—i.e., a school chooses lender X because they like the lender's servicing. The Department's role would remain as under current law.

<u>Would income-contingent loan repayment be available? (Yes or No and explain how it would work)</u> Yes. Any borrower could apply for ICR based on their post graduation economic circumstances.

It is envisioned that the borrower would submit an application to the specified administrative agency. If the borrower were selected for the program, the loan would be acquired by the government from the originating lender and placed with an agency specializing in ICR. The lender would be paid at par.

What federal agencies would be involved in the income contingent loan repayment? (Identify the agencies involved and briefly describe their role) The Internal Revenue Service and U.S. Department of Education. We recommend that ICR loans be owned by ED and servicing by an ED contractor with access to the necessary IRS data.

Would the student loan delinquency and default rates (however defined) decrease as a result of the proposal? (Please explain how). Both rates should dramatically decrease. Although the stated applicable interest rate on student loans could increase for some categories of students, all borrowers would have dramatically increased access to repayment relief based on their economic circumstances. Among the options available would be income contingent loan repayment. There will be very little reason for any borrower to default on their student loan.

How would loans be financed? (Describe all financing approaches that would apply) Current financing mechanisms would be continued. As noted above, however, the U.S. Department of Education would purchase loans where the borrower qualified for income contingent loan repayment. Because there would be no in-school interest subsidy the financing role of the Department would be significantly reduced. Also reduced would be the projected cost of federally-supported insurance.

If the proposal involves the use of federal funds, how is the cost of the funds to the loan provider determined? The proposal does not involve the use of federal funds by non-governmental loan providers.

Does any federal agency play a role in financing loans? (Example: federally-administered asset-back securities) The federal government would be responsible for financing loans on which the borrower qualified for income contingent loan repayment. On these loans, the applicable interest rate would be set at a level to produce cost neutrality to the government.

How is the borrower interest rate determined? The retail marketplace would determine the borrower interest rate, subject, of course, to relevant federal banking law. Lenders would compete in the marketplace for business. This process is likely to produce reduced borrower interest rates.

How would borrowers benefit from the proposal? (Please briefly explain how services or cost would benefit students) Borrowers are likely to receive lower cost loans because federal regulations governing the program would be reduced and lenders would be competing aggressively in the student loan marketplace. More importantly, borrowers choosing community service, suffering from under employment or unemployment, could receive subsidies pursuant to submitting an application outlining their circumstances. Qualifying borrowers could also receive income contingent loan repayment.

How would students and parent borrowers get information on student loan interest rates and related information? (Please specify the role ED, schools, and loan providers would play). Information comparing loan costs and terms would likely be posted on the Internet by several commercial concerns. If ED determined that the private sector information was too confusing or not available to all students, it could post this information on its web site. It is also anticipated that schools and loan providers would circulate information comparing loan costs.

Is the borrower cost subsidized by the federal government (other than the value of a federal guaranty)? Yes. Borrowers are eligible for various loan subsidies or income contingent loan repayment based on their post graduation circumstances.

How is the lender return determined? In the marketplace in setting the borrower interest rate. Other factors influencing lender return are defaults (which would be reduced), and administrative costs (also reduced due to deregulation). Lender return should remain at least constant even if borrower cost of loans is decreased.

<u>Would borrower rates increase or decrease as a result of the proposed changes in the program? (Please explain why. If not known, please indicate "unknown")</u> The cost of a student loan to a borrower under this proposal would be a function of the initial borrower interest rate and fees as well as the borrowers subsequent eligibility for benefits. The cost for many borrowers will decrease under the proposal. For borrowers experiencing hardship in repaying their loan, in particular, the cost of loans will be decreased.

Borrowers not experiencing hardship in repaying their loan are likely to pay more for their loans as a result of the transformation of the in-school interest subsidy into a repayment subsidy dependent on the borrowers post-school economic circumstances. A borrower with no economic duress would pay more under the proposal because even if the borrower's interest rate decreased, the loss of the in-school interest subsidy would increase the amount of indebtedness the borrower incurred by graduation.

<u>Does the borrower pay an origination fee?</u>
<u>(If yes, how would the amount of the fee be determined?)</u> The origination fee, if any, would be determined in the marketplace.

<u>Does the borrower pay an insurance premium?</u>
<u>(If so, to whom is the fee paid to?)</u> The insurance premium, if any, would be set by the guarantor involved. Because borrower benefits intended to address the needs of borrowers experiencing difficulty in repaying their loans would be increased, the incidence of default, and thus the need for an insurance premium, would be reduced.

<u>Would schools share in the risk of default?</u>
<u>(If yes, please explain how)</u> The proposal does not assume any school risk-sharing. Schools could offer to participate in the risk of default, however, as a means of reducing the cost of loans to students at their institution. Program regulations could eliminate current prohibitions on this type of participation in the loan.

<u>How would schools benefit from the changes in the student loan program?</u>
<u>(Example: Simpler origination process).</u> Greater market competition should benefit schools as well as students. Existing prohibitions on lender or guarantor assistance to schools would be repealed as a means of expanding market competition.

Would the repayment period be specified in the statute?
(If so, how long would the repayment period be?) The statute would not specify a maximum or minimum repayment period.

Would federal costs associated with student loans decrease?
(Please specify how. If not known, please indicate "unknown.") A significant reduction in federal costs associated with defaults is virtually certain, given that borrowers in duress would have access to expanded means of avoiding delinquency and default.

Additional Information on Proposal (please specify). The proposal would result in a redistribution of subsidies better reflecting the need of individual borrowers for help from the government. In the case of a borrower entering community service or otherwise facing difficulty in repaying their loan, the proposal creates dramatically increased subsidies. For most borrowers, loan forgiveness or assistance in repayment would be available. Only the most economically blessed borrowers would be ineligible for repayment subsidies and would pay more.

The proposal has been drafted in recognition that the old dichotomy of poor students receiving grants and wealthier students receiving loans no longer applies.